

The Week

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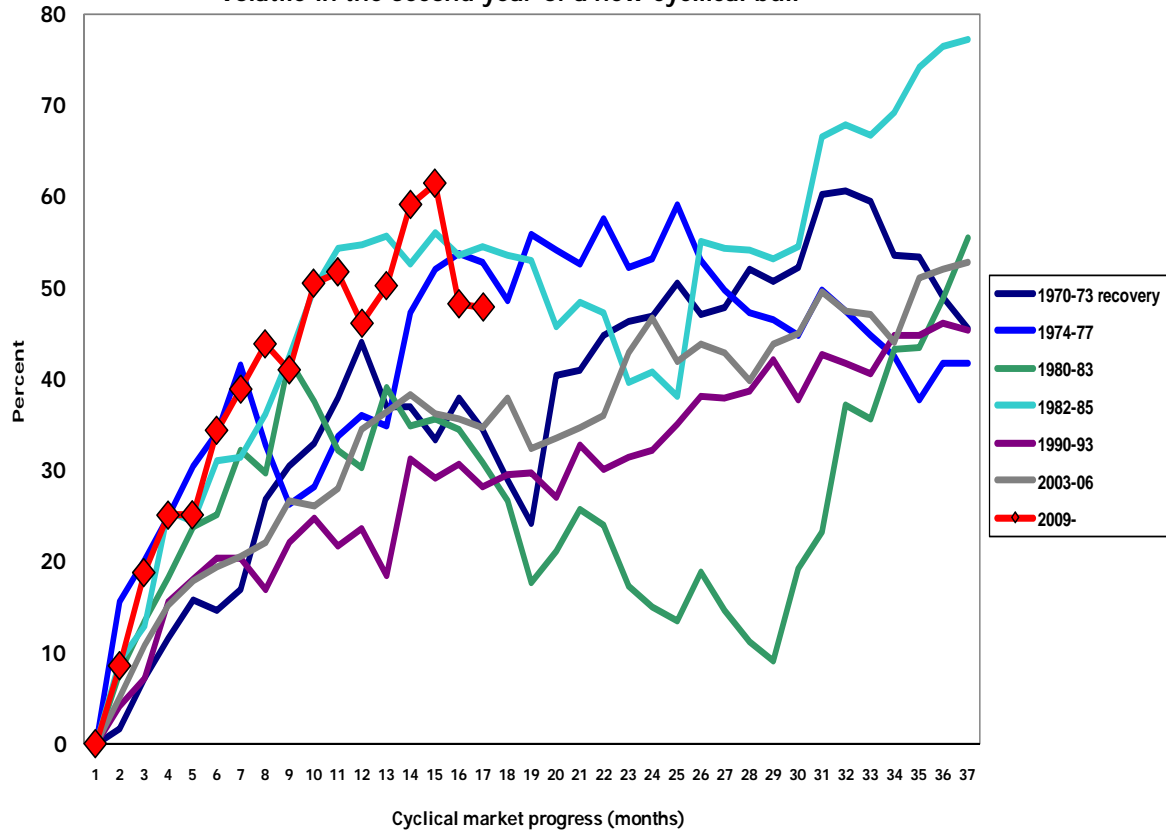
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The bumpy road to recovery continues – the 2010 mid-year outlook

Our economic and market outlook at mid-year has not changed significantly from the 2010 Outlook report, "A bumpy road to recovery", published earlier this year. The following points summarize the Wells Fargo Advisors 2010 outlook update, released last week, with analysis and forecasts by the strategists of the Advisory Services Group.

- Although we have adjusted some of our targets modestly, we still expect a bumpy road to recovery. We look for economic growth to be slower than normal and average 2.8% in the four quarters of 2010.
- We expect U.S. Consumer Price Index (CPI) inflation to be 2.0% in the 12 months ending December 2010. Inflation is likely to remain low, as net lending is still depressed and there is a lot of excess capacity in the economy keeping wage and price inflation low.
- We expected a modest dollar rally this year, but the dollar rallied by more than we anticipated. We now recommend a slight underweight to developed equity markets and a slight overweight to emerging equity markets until it is clear whether European policymakers will take all necessary steps to support the euro and avoid a recession.
- We remain positive but cautious on the equity markets. The S&P 500 hit our original year-end target of 1175-1200 in early April. More recently, we reduced our year-end target slightly to 1100-1140, given the weakness in foreign markets and volatile U.S. markets.
- For more than a year, the current market recovery has shown the same trajectory as the 1973-1974 and 1981-1982 market rebounds, which also began with swift, sharp rallies. And, just as the current recovery, those earlier rebounds also showed muted second year returns as the market worked off excesses from their initial rallies. The chart (next page) shows how the current market fits the historical pattern. The pattern also suggests a renewed rally in the third year of recovery. This pattern and the prospect of a continued economic recovery and higher earnings, lead us to expect the S&P 500 to rise back above the 1200 level in the first half of 2011.
- We continue to favor cyclically sensitive sectors such as Industrials, Materials and Telecom Services. However, these sectors could be under pressure during market weakness. Nonetheless, we believe long-term investors should use pullbacks to build positions in these sectors in anticipation of a stronger market in 2011.
- In taxable fixed income markets, we continue to recommend investors overweight the corporate bond sector. The recent widening of spreads presents an attractive opportunity to increase exposure and bring portfolios up to an overweight allocation. Municipal bonds continue to offer attractive value, especially since tax rates are likely to increase next year. We recommend investors focus on general-obligation and essential-purpose revenue debt.

Market performance of the S&P 500 is typically muted and more volatile in the second year of a new cyclical bull



Sources: Factset, Baseline, Wells Fargo Advisors

Past performance is not an indication of future results. An index is not managed and is unavailable for investment.

Forecasts and targets

	2010	2011
S&P 500 – Target	1100-1140 range*	1200-1220 range†
S&P 500 Earnings Per Share Estimate (EPS)	\$79	\$89
Real Gross Domestic Product (GDP) ‡	2.8%	2.3%
10-year U.S. Treasury Note Yield	3.00% - 4.00%	3.50%-4.50%

* Year-end 2010 target

† 12-month target from June 2010 to June 2011

‡ As of June 23, 2010. Fourth quarter to fourth quarter growth rate.

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